

**§ 635.413 Warranty clauses.**

The SHA may include warranty provisions in National Highway System (NHS) construction contracts in accordance with the following:

(a) Warranty provisions shall be for a specific construction product or feature. Items of maintenance not eligible for Federal participation shall not be covered.

(b) All warranty requirements and subsequent revisions shall be submitted to the Division Administrator for advance approval.

(c) No warranty requirement shall be approved which, in the judgment of the Division Administrator, may place an undue obligation on the contractor for items over which the contractor has no control.

(d) A SHA may follow its own procedures regarding the inclusion of warranty provisions in non-NHS Federal-aid contracts.

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**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[TD 8615]

RIN 1545-AQ81

**Special Rules for Determining Sources of Scholarships and Fellowship Grants**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulation.

**SUMMARY:** This document contains a final Income Tax Regulation that provides guidance for determining the source of scholarships, fellowship grants, grants, prizes and awards. The final regulation will affect both individuals and withholding agents. It will provide guidance concerning whether scholarships, fellowships, other grants, prizes and awards are U.S. source income subject to tax and withholding.

**DATES:** This regulation is effective August 25, 1995.

For dates of applicability of these regulations, see *Effective dates* in § 1.863-1(d)(4).

**FOR FURTHER INFORMATION CONTACT:** David Bergkuist (202) 622-3860 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:****Background**

This document contains a final Income Tax Regulation (26 CFR part 1)

under section 863 of the Internal Revenue Code. On June 15, 1993, a notice of proposed rulemaking (INTL 0041-92) was published in the **Federal Register** (58 FR 33060) (1993-2 C.B. 634). No public hearing was requested or held.

Written comments responding to the notice were received. After consideration of all of the comments, the regulation proposed under INTL-0041-92 is adopted as revised by this Treasury decision.

**Explanation of Revisions and Summary of Comments**

Section 863(a) authorizes the Secretary to provide regulations regarding the source of items of gross income other than those items specified in sections 861(a) and 862(a). Rules for determining the source of scholarships, fellowship grants, grants, prizes and awards are not provided by sections 861(a) and 862(a).

The notice of proposed rulemaking proposed in § 1.863-1(d)(1) that scholarships and fellowship grants be sourced by reference to the status of the grantor. However, it also provided a special rule in § 1.863-1(d)(2) for nonresident aliens who receive scholarships or fellowship grants, as defined in the regulations under section 117, from U.S. grantors with respect to study or research activities to be conducted outside the United States. Under these circumstances, the scholarship or fellowship grant would be treated as income from sources outside the United States.

The final regulation adopts the proposed regulation with certain changes. Paragraph (d)(1) clarifies that these rules do not apply to salaries or other compensation for services.

The final regulation provides rules for sourcing scholarships and fellowship grants in paragraphs (d)(2) (i) and (ii) by reference to the status of the grantor. The special rule of paragraph (d)(2)(iii) provides that scholarships or fellowship grants received by a person other than a U.S. person for activities conducted outside the United States are treated as income from sources without the United States.

Commentators asked that the regulation be expanded to encompass grants that fall outside the scope of section 117. In addition, commentators also suggested that the special rule be expanded to include prizes and awards given to nonresident aliens for their past artistic, scientific, or charitable achievements. These suggestions are included in this final regulation.

The source of grants, prizes and awards is determined by reference to the

status of the grantor under the general rules set forth in paragraph (d)(2) (i) and (ii). The term *grants* is defined in paragraph (d)(3)(iv) as amounts described in subparagraph (3) of section 4945(g) of the Code and the regulations thereunder and that are not otherwise scholarships, fellowship grants, prizes or awards as defined in § 1.863-1(d)(3). For purposes of paragraph (d)(3)(iv), the reference to section 4945(g)(3) is applied without regard to the identity of the payor or recipient and without the application of the objective and nondiscriminatory basis test and the requirement of a procedure approved in advance.

The term *prizes and awards* is defined in paragraph (d)(3)(iii) of this final regulation as having the same meaning as that set forth in section 74 and the regulations thereunder.

Under paragraph (d)(2)(iii), certain *targeted grants* and *achievement awards* received by a person other than a U.S. person for activities conducted outside the United States are treated as foreign source income. The term *targeted grants* does not appear elsewhere in the Code or the regulations. Targeted grants are a subset of the more inclusive term *grants*. Targeted grants may be received only from an organization described in section 501(c)(3), the United States, the States, or the District of Columbia and must be undertaken in the public interest without private financial benefit. The term *achievement award* does not appear elsewhere in the Code or regulations. An achievement award is an award issued by an organization described in section 501(c)(3), the United States, a State, or the District of Columbia for a past activity undertaken in the public interest and not primarily for the private financial benefit of a specific person or persons or organization.

Commentators requested that the final regulation provide express guidance for the issuance of scholarships or fellowship grants by agents on behalf of foreign grantors. No change is made in the final regulation because an actual payment made by a genuine agent of the payor does not alter the source. The final regulation looks to the status (i.e., whether the person is a U.S. person or a foreign person) of the payor rather than the agent.

The term *international agency* in paragraph (d)(1) of the proposed regulation has been replaced in the final regulation with the term *international organization* as defined in section 7701(a)(18). This clarification uses the Code definition for such organizations.

Comments were received regarding the proposed regulation suggesting that

the scope of the regulation be expanded to cover scholarships and fellowship grants awarded by charitable trusts. The final regulation changes the proposed language of "U.S. citizen or resident, a domestic corporation, \* \* \*" in paragraph (d)(2)(i) to include a domestic partnership, or an estate or trust (other than a foreign estate or trust within the meaning of section 7701(a)(31)). The special rule of paragraph (d)(2)(iii) has been clarified to apply to scholarships, fellowship grants, targeted grants, and achievement awards received by a person other than a U.S. person as defined in section 7701(a)(30).

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to this regulation, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Small Business Administration for comment on its impact on small business.

### Drafting Information

The principal authors of this regulation are George A. Hani, formerly of the Office of Associate Chief Counsel (International), IRS and David Bergkuist of the Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in its development.

### List of Subjects in 26 CFR Part 1

Income taxes, Reports and recordkeeping requirements.

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

**Authority:** 26 U.S.C. 7805. \* \* \*

Section 1.863-1 also issued under 26 U.S.C. 863(a). \* \* \*

**Par. 2.** In § 1.863-1, paragraph (d) is added to read as follows:

### § 1.863-1 Allocation of gross income under section 863(a).

\* \* \* \* \*

(d) *Scholarships, fellowship grants, grants, prizes and awards*—(1) *In general.* This paragraph (d) applies to scholarships, fellowship grants, grants, prizes and awards. The provisions of this paragraph (d) do not apply to amounts paid as salary or other compensation for services.

(2) *Source of income.* The source of income from scholarships, fellowship grants, grants, prizes and awards is determined as follows:

(i) *United States source income.* Except as provided in paragraph (d)(2)(iii) of this section, scholarships, fellowship grants, grants, prizes and awards made by a U.S. citizen or resident, a domestic partnership, a domestic corporation, an estate or trust (other than a foreign estate or trust within the meaning of section 7701(a)(31)), the United States (or an instrumentality or agency thereof), a State (or any political subdivision thereof), or the District of Columbia shall be treated as income from sources within the United States.

(ii) *Foreign source income.* Scholarships, fellowship grants, grants, prizes and awards made by a foreign government (or an instrumentality, agency, or any political subdivision thereof), an international organization (as defined in section 7701(a)(18)), or a person other than a U.S. person (as defined in section 7701(a)(30)) shall be treated as income from sources without the United States.

(iii) *Certain activities conducted outside the United States.* Scholarships, fellowship grants, targeted grants, and achievement awards received by a person other than a U.S. person (as defined in section 7701(a)(30)) with respect to activities previously conducted (in the case of achievement awards) or to be conducted (in the case of scholarships, fellowships grants, and targeted grants) outside the United States shall be treated as income from sources without the United States.

(3) *Definitions.* The following definitions apply for purposes of this paragraph (d):

(i) *Scholarships* are defined in section 117 and the regulations thereunder.

(ii) *Fellowship grants* are defined in section 117 and the regulations thereunder.

(iii) *Prizes and awards* are defined in section 74 and the regulations thereunder.

(iv) *Grants* are amounts described in subparagraph (3) of section 4945(g) and the regulations thereunder, and are not amounts otherwise described in

paragraphs (d)(3) (i), (ii), or (iii) of this section. For purposes of this paragraph (d), the reference to section 4945(g)(3) is applied without regard to the identity of the payor or recipient and without the application of the objective and nondiscriminatory basis test and the requirement of a procedure approved in advance.

(v) *Targeted grants* are grants—

(A) Issued by an organization described in section 501(c)(3), the United States (or an instrumentality or agency thereof), a State (or any political subdivision thereof), or the District of Columbia; and

(B) For an activity undertaken in the public interest and not primarily for the private financial benefit of a specific person or persons or organization.

(vi) *Achievement awards* are awards—

(A) Issued by an organization described in section 501(c)(3), the United States (or an instrumentality or agency thereof), a State (or political subdivision thereof), or the District of Columbia; and

(B) For a past activity undertaken in the public interest and not primarily for the private financial benefit of a specific person or persons or organization.

(4) *Effective dates.* The following are the effective dates concerning this paragraph (d):

(i) *Scholarships and fellowship grants.* This paragraph (d) is effective for scholarship and fellowship grant payments made after December 31, 1986. However, for scholarship and fellowship grant payments made after May 14, 1989, and before June 16, 1993, the residence of the payor rule of paragraph (d)(2) (i) and (ii) of this section may be applied without applying paragraph (d)(2)(iii) of this section.

(ii) *Grants, prizes and awards.* This paragraph (d) is effective for payments made for grants, prizes and awards, targeted grants, and achievement awards after September 25, 1995. However, the taxpayer may elect to apply the provisions of this paragraph (d) to payments made for grants, prizes and awards, targeted grants, and achievement awards after December 31, 1986, and before September 26, 1995.

**Margaret Milner Richardson,**  
*Commissioner of Internal Revenue.*

Approved: August 3, 1995.

**Leslie Samuels,**  
*Assistant Secretary of the Treasury.*  
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